

Message Text

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TAGS: ECON, OECD

SUBJECT: ECONOMIC POLICY COMMITTEE MEETING NOV 18-19

REF: USOECD 27750

1. SUMMARY: GENERAL CONSENSUS OF EPC WAS THAT CONTROL OVER INFLATION IS STILL HIGHEST PRIORITY, ALTHOUGH COUNTRIES ARE NOW MORE PREPARED THAN AT JUNE EPC TO TAKE SELECTED EXPANSIONARY MEASURES TO OFFSET SECTORAL UNEMPLOYMENT. MOST COUNTRIES CONSIDERED SECRETARIAT FORECASTS TO BE OVERLY PESSIMISTIC FOR 1975 AND MAINTAINED THAT "NO POLICY CHANGE" ASSUMPTION WAS UNREALISTIC OR THAT RECOVERY WOULD TAKE PLACE DESPITE RESTRICTIVE POLICY STANCE. THERE WAS CONSIDERABLE SENTIMENT AMONG DEFICIT COUNTRIES AND

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SMALLER COUNTRIES THAT SURPLUS COUNTRIES SHOULD BE

FIRST TO REFLATE THEIR ECONOMIES. COUNTRIES WERE DIVIDED ON DESIRABILITY OF USING INCOME POLICIES TO SUPPLEMENT DEMAND MANAGEMENT, BUT AGREED TO ASK WP-4 TO STUDY QUESTION FURTHER. RELATIVELY LITTLE ATTENTION WAS DIRECTED TO EFFECTS OF U.S. DOWNTURN ON REST OF WORLD. SEVERAL COUNTRIES CALLED FOR GREATER EFFORTS AT INTERNATIONAL COOPERATION AND CONCERTATION OF POLICIES. END SUMMARY.

2. CHAIRMAN'S VIEWS: CHAIRMAN SIR DOUGLAS ALLEN CLAIMED TO SEE LESS POLARIZATION THAN IN JUNE BETWEEN THOSE WHO FAVORED PROLONGED RESTRAINT TO CONTROL INFLATION AND THOSE WHO FAVORED EARLY EXPANSION TO COMBAT UNEMPLOYMENT (SEE REFTTEL). COUNTRIES WERE NOW MORE PREPARED, HE THOUGHT, TO MODIFY RESTRICTIVE POLICIES TO AVOID EXCESSIVE SLACK, ALTHOUGH DIFFERING IN THEIR ASSESSMENT OF HOW SOON AND TO WHAT EXTENT THIS MIGHT BE NECESSARY.

3. SECRETARIAT VIEWS: MAIN QUESTION FOR EPC WAS TO WHAT EXTENT ECONOMIES SHOULD BE ALLOWED TO SLOW DOWN IN ORDER TO FIGHT INFLATION BEFORE POLICY CHANGES WOULD BE REQUIRED TO WARD OFF RECESSION. SECRETARIAT WAS CONCERNED THAT COUNTRIES MIGHT MAINTAIN ANTI-INFLATIONARY DEMAND MANAGEMENT POLICIES TOO LONG, AND THEN BE FORCED BY POLITICAL PRESSURES TO REFLATE RAPIDLY TO COMBAT UNEMPLOYMENT, WITH DISASTROUS IMPACT ON LONG-RUN CHANCES OF WINNING ANTI-INFLATIONARY STRUGGLE. SECRETARIAT CLEARLY FAVORED EARLY RELAXATION OF DEMAND MANAGEMENT POLICIES, COMBINED WITH SOME FORM OF "SOCIAL CONTRACT" (E.G. INCOMES POLICY) TO RESTRAIN WAGE-PUSH ELEMENT OF INFLATION. SECRETARIAT PROPOSED THAT EPC'S WORKING PARTY 4 BE ASKED TO STUDY USEFULNESS OF INCOMES POLICIES AS AN ADJUNCT TO DEMAND MANAGEMENT. MOST COUNTRIES SUPPORTED THIS SUGGESTION.

4. SECRETARIAT ALSO RAISED INTERESTING QUESTION OF STRUCTURAL IMPACT OF ENERGY SITUATION ON OECD ECONOMIES, AND WHETHER COUNTRIES HAVE SAME CAPACITY TO EXPAND AS BEFORE. EPC AGREED THAT THIS POINT BE EXAMINED FURTHER LIMITED OFFICIAL USE

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BY WP-2 IN DECEMBER.

5. GENERAL OUTLOOK: DESPITE CHAIRMAN'S CONCLUSION THAT THERE WAS LESS POLARIZATION IN VIEWS THAN AT JUNE EPC, THERE REMAIN CONSIDERABLE DIFFERENCES OF OPINION REGARDING NATURE OF PROBLEMS AND POLICIES NEEDED TO DEAL WITH THEM. ALL LARGE COUNTRIES WITH EXCEPTION OF U.K. CONTINUE TO SEE INFLATION AS NUMBER ONE PROBLEM.

THESE COUNTRIES ARGUED WITH RELATIVE DEGREES OF
CONVICTION THAT PRESENT RESTRICTIVE POLICY STANCE
SHOULD BE MAINTAINED AND THAT TO REFLATE NOW WOULD
ONLY GIVE ADDED IMPETUS TO INFLATION AND ENCOURAGE
LARGE WAGE DEMANDS AT NEXT BARGAINING ROUND. MOREOVER,
SUCH ACTION WOULD HAVE LITTLE IMMEDIATE IMPACT ON
EMPLOYMENT LEVELS. IT WAS NO COINCIDENCE THAT ALL OF
THESE COUNTRIES BELIEVED THAT OUTPUT AND DEMAND IN
THEIR COUNTRIES WOULD TURN OUT TO BE STRONGER IN 1975
THAN FORECAST BY SECRETARIAT. MOST OF THESE COUNTRIES

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ALSO WERE OF OPINION THAT ECONOMIC SITUATION IS
MANAGEABLE.

6. U.S. DELEGATE (GREENSPAN) STRESSED NEED TO CONTROL INFLATION IF FINANCIAL AND ECONOMIC INSTITUTIONS ARE TO CONTINUE TO OPERATE EFFECTIVELY. GERMANY AND AUSTRALIA AGREED THAT CACK OF BUSINESS CONFIDENCE WAS CAUSED BY EXCESSIVE INFLATION, NOT BE INADEQUATE GROWTH. AUSTRALIAN DELEGATE CITED DEPRESSING EFFECT ON INVESTMENT OF COMPANY PROFIT SQUEEZE AND HIGH COSTS OF BORROWING ON CAPITAL MARKETS, AND EXPRESSED HIS OPINION THAT UNEMPLOYMENT WOULD CONTINUE TO RISE IF INFLATION WAS NOT BROUGHT UNDER CONTROL. (THIS VIEW CREATES LINK RATHER THAN TRADE-OFF BETWEEN INFLATION LIMITED OFFICIAL USE

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AND UNEMPLOYMENT.) AUSTRALIAN DELEGATE CONCLUDED THAT UNLESS LARGE COUNTRIES CAN MASTER INFLATION BY MAINTAINING RESTRICTIVE STANCE, SMALLER COUNTRIES WOULD FIND IT DIFFICULT TO WARD OFF EFFECTS OF IMPORTED INFLATION ON THEIR OWN ECONOMIES.

7. OPPOSITE VIEWPOINT WAS EXPRESSED BY U.K., MOST SMALL COUNTRIES, AND TO CERTAIN EXTENT ITALY. THEY CONSIDERED SOME KIND OF EXPANSIONARY MEASURES WERE REQUIRED TO AVOID WORLD RECESSION. THIS GROUP GENERALLY CONSIDERED THAT IT WAS INCUMBENT ON SURPLUS COUNTRIES TO PURSUE RELATIVELY EXPANSIONARY POLICIES, BUT WITHOUT IMPLYING THAT DEFICIT COUNTRIES NECESSARILY FOLLOW OPPOSITE COURSE. SEVERAL COUNTRIES (U.K., SPAIN, N.Z.) ARGUED THAT DEMAND MANAGEMENT POLICIES WOULD BE UNLIKELY BY THEMSELVES TO HAVE SIGNIFICANT IMPACT ON INFLATION, AND THAT GAINS TO BE MADE ON INFLATION FRONT WERE NOT SUFFICIENT TO JUSTIFY RISKS OF RECESSION. SOME COUNTRIES SAW ANSWER IN BALANCED POLICY OF MODEST RELAXATION COMBINED WITH SOME FORM OF INCOMES POLICY OR "SOCIAL CONTRACT" TO MAINTAIN EMPLOYMENT WHILE CURBING WAGE-PUSH ELEMENT OF INFLATION.

8. U.K. DELEGATE (WASS) QUESTIONED THEORETICAL BASIS FOR ASSUMING THAT DEMAND MANAGEMENT COULD SIGNIFICANTLY AFFECT INFLATION/EMPLOYMENT TRADE-OFF. HE SUGGESTED THAT WAGE PRESSURES WERE NOT RESPONSIVE TO DEMAND LEVELS SINCE, AS UNEMPLOYMENT RISES, LABOR UNIONS BECOME MORE DETERMINED TO GET WAGE INCREASES IN ORDER TO FORCE STIMULATION OF DEMAND. THUS DEMAND RESTRAINT MAY HAVE LITTLE IMPACT ON INFLATION LEVELS BECAUSE TRANSMISSION EFFECT IS WEAK.

9. INCOMES POLICIES. SECRETARIAT SUGGESTION THAT DEMAND MANAGEMENT POLICIES SHOULD BE RELAXED WHILE INCOMES POLICIES ARE TIGHTENED MET WITH

PREDICTABLE RANGE OF REACTIONS FROM EPC MEMBERS.
U.S. (GREENSPAN) SAID INCOMES POLICIES HAD NOT WORKED
IN U.S. AND IN FACT MAY HAVE CONTRIBUTED TO PRESENT
HIGH INFLATION RATE BY RETARDING GROWTH OF CAPACITY
AND CREATING SHORT SUPPLY SITUATIONS. HE THOUGHT
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"SOCIAL CONTRACT" WOULD NOT WORK IN COUNTRY WHERE
UNIONS ONLY CONTROL 25 PERCENT OF TOTAL LABOR FORCE
AND CANNOT TAKE RESPONSIBILITY FOR DELIVERING
ON AGREEMENTS. MOREOVER, UNFAVORABLE SHIFT OF PHILLIPS
CURVE ASSOCIATED WITH SOCIAL BENEFITS PROGRAMS
MEANT THAT USUAL WAGE PRICE/EMPLOYMENT TRADE-OFFS
WERE DETERIORATING, PARTICULARLY IN SITUATION OF STRONG
INFLATIONARY EXPECTATIONS. GERMANY AND JAPAN WERE
EQUALLY UNCONVINCED REGARDING BENEFITS OF INCOMES POLICY,
ESPECIALLY AS A SUBSTITUTE FOR DEMAND MANAGEMENT.
NORWAY HELPED PUT MATTERS IN PERSPECTIVE BY DEFINING
INCOMES POLICY AS ANY ATTEMPT BY GOVERNMENT TO IN-
FLUENCE PROCESS OF WAGE AND PRICE FORMATION OTHER THAN
BY DEMAND MANAGEMENT POLICY. UNDER THIS DEFINITION,
EVEN GERMANY AND JAPAN WERE INDULGING IN SUCH POLICIES
BY MEANS OF WAGE DISCUSSION ROUNDS WITH PRIVATE SECTOR.
NORWAY ALSO NOTED THAT INCOMES POLICIES OF ALL TYPES
WERE MEANT TO COMPLEMENT, NOT SUBSTITUTE FOR DEMAND
MANAGEMENT. OTHER COUNTRIES (UK, FRANCE, ITALY AND
MOST SMALL COUNTRIES) AGREED THAT SOME FORM OF IN-
COMES POLICY COULD BE USEFUL SUPPLEMENT TO DEMAND
MANAGEMENT, AND SUPPORTED SECRETARIAT PRO-
POSAL FOR FURTHER EXAMINATION OF INCOMES POLICIES BY
EPC'S WORKING PARTY 4. ONLY GERMANY EXPRESSED DOUBT
REGARDING USEFULNESS OF SUCH STUDY.

10. POLICY STANCE OF MAJOR COUNTRIES:

A. US (GREENSPAN) DID NOT FORSEE ANY SUBSTANTIAL CHANGE

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IN POLICY STANCE, BUT STRESSED THAT POLICIES WERE
CONSTANTLY UNDER REVIEW AND WOULD REACT FLEXIBLY TO
EVENTS. GREENSPAN EMPHASIZED CURRENT POLICY DILEMMA
OF WORSENING PHILLIP'S CURVE TRADE-OFF WHICH MEANT THAT
IT WAS MORE DIFFICULT TO REDUCE UNEMPLOYMENT WITHOUT
STILL MORE INFLATION. AT SEME TIME, WE RAN RISK OF
BREAKING BACK OF CAPITAL GOODS MARKET IF WE CONTINUED
TO PRESS TOO HARD ON INFLATION. GREENSPAN EXPECTED US
ECONOMY TO BOTTOM OUT IN SPRING OF 1975 AS HOUSING
AND AUTOS HIT LOWEST POINT, WITH RECOVERY COMING IN
SECOND HALF OF 1975 AND EARLY 1976. NORWEGIAN DELEGATE
POSED QUESTION REGARDING LEVEL OF UNEMPLOYMENT IMPLIED
BY THIS OUTLOOK, TO WHICH GREENSPAN REPLIED THAT PEAK
OF 6.5 - 7 PERCENT MIGHT BE REACHED IN SPRING.

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SECRETARIAT (FAY) EXPRESSED DOUBT THAT UNEMPLOYMENT
WOULD STOP RISING UNTIL US RETURNED CLOSER TO LONG TERM
GROWTH PATH, WHICH MIGHT NOT HAPPEN BEFORE 1976.
SECRETARIAT ALSO EXPRESSED VIEW THAT CAPITAL
GOODS MARKETS MIGHT NOT BE ON VERGE OF RECOVERY IN VIEW
OF REPORTS (MCGRAW-HILL) THAT INVESTMENT EXPECTATIONS
ARE FOR ZERO GROWTH IN 1975.

B. GERMANY PUBLICLY ACCEPTED FACT THAT "SOME COUNTRIES" WILL HAVE TO SHOULDER MORE RESPONSIBILITIES THAN OTHERS, AND POINTED OUT THAT GERMANY IS ALREADY EXPANDING FISCAL EXPENDITURES AND WILL SHORTLY GIVE ADDED STIMULUS TO ITS ECONOMY VIA REFORM OF TAX SYSTEM. SCOPE FOR FURTHER EXPANSION ON EXPENDITURES SIDE IS LIMITED BY FINANCING CONSTRAINTS AND POSSIBLE ADVERSE EFFECTS OF COMPETITION FOR FUNDS ON CAPITAL MARKETS. GERMANS HINTED AT NEW MEASURES TO STRENGTHEN PRIVATE CONSUMPTION AND STATED GENERAL INTENTION TO REDUCE ROLE OF EXPORTS IN DEMAND AGGREGATES. MONETARY POLICY WILL BE LOOSENED, BUT NOT TO EXTENT OF BECOMING EXPANSIONARY (RATE OF GROWTH OF MONEY SUPPLY MAY INCREASE FROM CURRENT 5.5 - 6 PERCENT TO 7.5 - 8 PERCENT). SCOPE FOR FURTHER RELAXATION WILL DEPEND LARGELY ON WHETHER NEXT WAGE BARGAINING ROUND CAN LIMIT WAGE INCREASES TO 8 PERCENT.

C. JAPAN BELIEVES CURRENT RESTRICTIVE POLICIES SHOULD BASICALLY BE MAINTAINED, BUT HINTED THAT SPECIAL MEASURES OF RELIEF MIGHT BE NECESSARY FOR HARD HIT AREAS. THEY EXPECT EVEN WITHOUT CHANGE OF POLICY THAT RECOVERY WILL BEGIN IN FINAL QUARTER DUE TO PICK-UP IN CONSUMER DEMAND RESULTING FROM MASSIVE WAGE INCREASES IN SPRING. THEY CAREFULLY AVOIDED RESPONDING TO SUGGESTIONS BY NETHERLANDS THAT POSITIVE OUTLOOK FOR GNP GROWTH AT 5 PERCENT RATE IN 1975 (VERSUS SECRETARIAT 2 PERCENT) WOULD BE LARGELY EXPORT LED.

D. FRANCE ALSO INTENDS TO MAINTAIN RESTRICTIVE STANCE BUT INDICATED POSSIBILITY THAT REFLATIONARY POLICIES MIGHT BE INTRODUCED SECTORALLY RATHER THAN GLOBALLY. FRANCE ALSO NOTED THAT SURPLUS COUNTRIES HAVE ROLE TO PLAY IN THIS RESPECT. FRENCH POLICIES WILL FOR TIME BEING CONTINUE TO EMPHASIZE STRICT CREDIT AND PRICE CONTROLS AND MODEST GROWTH OF GOVERNMENT EXPENDITURES.

E. UK AND ITALY: UK HAS ALREADY INTRODUCED MILDLY LIMITED OFFICIAL USE

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REFLATIONARY BUDGET WHICH IS AIMED AT TRANSFERRING RESOURCES FROM PRIVATE CONSUMPTION INVESTMENT TO INDUSTRIAL INVESTMENT AND EXPORTS. UK BELIEVES THAT DEFICIT COUNTRIES WITH SEVERE UNEMPLOYMENT OR WEAK DOMESTIC DEMAND SHOULD NOT BE EXPECTED TO DEFLATE FURTHER. ITALY, ON OTHER HAND, ACCEPTED THAT IT WOULD HAVE TO MAINTAIN AND EVEN ACCENTUATE RESTRICTIVE POLICIES IN ORDER TO NARROW ITS EXTERNAL DEFICIT, BUT FULLY RECOGNIZED THAT

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THIS MIGHT CAUSE RECESSION.

11. BALANCE OF PAYMENTS: DISCUSSION OF BP SITUATIONS
WAS BRIEF IN VIEW OF PENDING WP-3 MEETING LATER IN AFTER-
NOON OF NOV. 19. GERMANY AND JAPAN BOTH RESTATED EXPECT-
TATIONS, EXPRESSED IN SHORT TERM FORECASTERS MEETING,
THAT STRONGER DOMESTIC GROWTH WOULD TEND TO REDUCE TRADE
SURPLUSES. US(WIDMAN) CHALLENGED SECRETARIAT FIGURES OF
5.5 PERCENT GROWTH IN OECD OIL IMPORT VOLUMES IN 1975 AT
TIME WHEN GNP GROWTH EXPECTED TO BE ONLY 0.5 PERCENT. HE
ALSO NOTED PROSPECTS FOR BRINGING DOWNWARD PRESSURE ON
OIL PRICES IF OECD COUNTRIES COULD REDUCE OIL IMPORTS BY
3 MILLION BARRELS PER DAY BY END 1975. IN MEANTIME,
FINANCING NEEDS COULD BE MET BY RECYCLING MECHANISMS WITH
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IN OECD GROUP OF COUNTRIES. WIDMAN OUTLINED SECRETARY SIMON'S PROPOSALS FOR SUCH A RECYCLING MECHANISM ASSOCIATED WITH OECD.

12. SECRETARIAT (MARRIS) ADMITTED OIL IMPORT GROWTH FIGURES WERE TOO HIGH, BUT DOUBTED THAT OIL PRICES COULD BE BROUGHT DOWN BY REDUCING CONSUMPTION. IN HIS VIEW, PRICE OF OIL IS CARTEL DETERMINED AND THUS MARKET FORCES ARE UNLIKELY TO HAVE MUCH IMPACT. THUS, SECRETARIAT EXPECTS CONTINUED RISE IN OIL PRICES IN 1975. SWITZERLAND, TOO, WAS DOUBTFUL REGARDING PROSPECTS FOR REDUCING OIL PRICES BY CUTTING CONSUMPTION, AND THOUGHT CONSUMING COUNTRIES WOULD BE LUCKY TO AVOID FURTHER INCREASES BASED ON SOME FORM OF INDEXATION OF OIL PRICES TO WORLD RATES OF INFLATION. SWITZERLAND ALSO CONCERNED THAT RECYCLING MECHANISMS, ALTHOUGH WELCOME' MIGHT NOT BE SUFFICIENT ANSWER TO BALANCE OF PAYMENTS PROBLEMS, SINCE SOME COUNTRIES WOULD BE ASSUMING INCREASING LEVELS OF INDEBTEDNESS WHICH WOULD HAVE TREMENDOUS IMPACT IF DEFAULTS OCCURRED. SECRETARIAT RESPONDED THAT MAIN PROBLEM WAS NOT SIZE OF DEBT BUT ITS UNEVEN DISTRIBUTION AMONG OECD MEMBERS. TURNER

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